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**Memorandum**

For: House Republicans

From: Dick Armey

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Re: The Next Big Challenge: Re-Limiting Government

Congratulations on a successful year so far. Despite the other party's unexpected takeover of the Senate last month, Congress has racked up a sizable list of accomplishments. Rather than recite that list here, I'm attaching a copy for your perusal. I think you'll agree it's a strong record.

As we celebrate the Fourth, and look ahead to the second half of this session, this seems a good time to step back and contemplate the bigger picture: What's the next big challenge for our party and our country?

**How Far We've Come**

America today is prosperous and free in ways that were unimaginable a generation ago. We tend to forget that the 1970s were the most dangerous decade since the '30s. Racked by inflation, unemployment, tax-bracket creep, gasoline rationing, and a

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government-induced energy crisis, America seemed destined for permanently lower living standards. For a time, it actually made more economic sense to buy something on your credit card than to invest in America's future. We were on the brink of an economic meltdown.

But by adopting common-sense conservative policies—sound money, supply-side tax cuts, reduced regulation—and by strongly reaffirming the virtues of the free market, we brought the country out of a disaster and saved it from catastrophe.

If liberal policies had prevailed, the malaise and recession of the '70s might have gone on for years or decades. Instead, the economy has grown almost continuously

since November 1982, the longest expansion in our history. And thanks to that surge of strength, we were able to revitalize our armed forces, reclaim our world standing, and win the Cold War without firing a shot.

Conservative policies continue to make America better. We prevented the Left from nationalizing child care in '89 and health care in '94. We reformed welfare in '96 and balanced the budget in '98. Taking a page from President Reagan, we cut marginal tax rates again this year to promote growth and job creation.

In a word, over the past generation conservative policies have kept the United States from becoming another France or Japan—a country groaning under bureaucracy, regulation, and high taxes. That by itself is cause for rejoicing.

But is it enough? Did we Republicans come to Washington merely to slow the growth of leviathan government? Or did we come to shrink and re-limit it? *I say we came here to shrink and re-limit it.* Until we do, our liberties are potentially in danger, all our recent progress potentially at risk. Without the restoration of limited government, we cannot be sure we are leaving to our children a country as free, as safe, or as prosperous as the one we inherited.

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### **A Four-Point Plan**

Now, the Beltway wasn't built in a day. Rolling back big government will take decades. That's why we need a step-by-step plan, and ways to measure our progress. In that spirit, I would like to propose four major goals for conservatives to pursue over the coming decade:

**First.** *Preserve the 2001 tax cut and make it permanent.* With that tax cut, we effectively ceded a whole percentage point of GDP back to the private sector, in perpetuity. We mustn't let the government take that freedom away.

**Second.** *Keep cutting taxes incrementally, in ways that move us toward our ultimate goal of fundamental tax reform,* be it the flat tax or a similar reform. A couple of good first candidates: Expand IRAs and eliminate the capital gains tax.

**Third.** *Enact free-market health reforms,* because, as *National Review* advises, “if Republicans don't reform health care themselves, the system will evolve in a socialist direction while doing constant damage to the party of liberty on the way.”

Clintoncare may have been defeated, but Senator Clinton has been getting her revenge, and Senator Kennedy his legislative wish, piece by piece. Clintoncare is happening incrementally, and we must stop it. How? By enacting MSAs and tax equity for the uninsured and self-insured—ASAP.

***Fourth and finally.*** *Preserve and strengthen Social Security—the right way.* This subject is so important, I hope you'll forgive me a lengthy discussion.

### **The Unavoidable Crisis**

Later this year, a bipartisan commission appointed by President Bush and chaired by former Senator Daniel Patrick Moynihan and Richard Parsons of AOL-Time Warner will issue a plan for saving Social Security from bankruptcy. We will find ourselves in a national debate on Social Security reform, whether we like it or not.

The numbers are inexorable. Ten years from now, the Baby Boom will begin retiring. By 2016, a shrinking population of workers will no longer be able to support the growing population of beneficiaries.

*Social Security is underfunded to the tune of \$22 trillion.*

By 2038, the Social Security trust fund will officially be “empty” and, if no action has been taken by then, benefit checks will have to be slashed by about 30 percent across the board. To keep things from getting any worse during the remainder of the century, Congress will have to make the benefit cuts permanent, raise taxes by 50 percent, deficit-spend on a massive scale, or adopt some combination of these measures.

To be sure, right now Social Security is taking in more money from the payroll tax than it spends. A good deal more. But that money is not being—never has been—set aside for future benefits. For decades, the Democrats used it for social welfare spending. In 1999, we put a stop to that and are now using it to pay down the national debt.

The hard truth is the Social Security trust fund is empty. It's a mere accounting device. To understand how it works, imagine a parent secretly taking dollar bills out of a shoebox that contains his child's college-education fund and replacing them with handwritten notes pledging to return the money, with interest, when the child reaches college age. That is our Social Security trust fund. The dollar bills are today's payroll-tax revenue, and Congress is the sneaky parent who has been using the money for non-Social Security purposes and replacing it with mere paper promises. And guess what? “Later” has arrived.

In actuarial terms, Social Security is underfunded to the tune of \$22 *trillion* between 2016 and 2075. That's an obligation equal to:

- ?? 3 times the size of the current GDP.
- ?? 7 times the size of the current national debt.
- ?? 11 times the size of this year's federal budget.
- ?? 75 times the size of this year's defense budget.
- ?? 750 times the size of this year's education budget.

The longer we delay corrective action, the more difficult and costly it will be to avert disaster. We may feel tempted to hide from the issue, but we can't and we shouldn't. If we do nothing, we can say goodbye to many of the hard-won fiscal gains of the past half-decade—and hello to a permanently diminished future of rising deficits, debt, and taxes. The federal budget will increasingly become a vehicle for transferring funds from workers to retirees, with increasingly little room for defense and veterans, education, health care, and other priorities.

### **A Not So Good Deal**

In addition to its pending insolvency, Social Security suffers from two other important problems: (1) It creates no real assets that people can leave to their loved ones, and (2) its average rate of return has been shrinking with each passing generation. For example, people born in the 1960s can expect a mere 2 percent return at best—worse than treasury bonds. Children born this year can expect a *negative* return—worse than passbook savings or putting the money under a mattress. These abysmal returns are *worse* for blacks, Hispanics, and other Americans who have shorter-than-average life expectancies. Happily, these problems can be remedied by letting workers invest their own payroll tax dollars in personal retirement accounts.

Creating personal accounts within Social Security is a controversial idea to many Democrats, because it represents a shift of power and control from the government to individuals. But it is getting increasingly hard for the idea's opponents to resist it. The status quo has become indefensible, and personal accounts would not only help restore the program's solvency, they would make Social Security a better deal for everyone, especially the poor and ethnic minorities.

The Moynihan-Parsons Commission plan will probably include personal accounts and may include some other, politically unpleasant choices. While we can probably count on a few honest Democrats like former Senators Moynihan and Kerrey and Rep. Charlie Stenholm to speak the truth, most Democrats will be strongly tempted to use the Commission plan as a political weapon against Republicans, regardless of its specifics. Our best shield, as always, will be good public policy.

I think we needn't fear the Commission plan, so long as it (1) protects the benefits of all current retirees and those nearing retirement, (2) returns the system to a sound and sustainable financial footing, and (3) allows younger workers to improve their rates of return using personal retirement accounts.

### Our Options

We have four options for making Social Security solvent over the next 75 years: raise taxes, cut benefits, deficit-spend, or create personal accounts.

Raising the payroll tax should *not* be an option. It is already too high, and falls hardest on the poorest workers. Democrats are on record favoring payroll tax hikes. We should resist them—and remind the voters.

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true reform.*

Equally undesirable are benefit cuts such as raising the retirement age, cutting cost-of-living adjustments, or “taxing” the benefits of “rich” seniors. Such austerity measures worsen real rates of return and hit poor folks hardest.

And the fact is neither raising taxes nor cutting benefits creates *sustainable* solvency. These gimmicks merely postpone insolvency—kick the problem down the road for future generations to wrestle with. Only personal accounts deserve the name of true reform:

- ?? Only personal accounts create sustainable solvency.
- ?? Only personal accounts increase real rates of return.
- ?? Only personal accounts create assets that can be passed on to loved ones.
- ?? Only personal accounts make it possible to reduce the payroll tax over time.

To be sure, there is no free lunch. The transition to personal accounts will cost a lot of money. But thankfully, we can afford it with a combination of available budget surpluses, higher returns from investing the money, and perhaps some *temporary* austerity measures. There is probably no way to avoid *any* austerity; the hour is too late for that. But the sooner we start, the less the transition will cost. Remember, procrastinating doesn't spare us from pain, it only makes it worse. And once the transition to accounts is complete, the permanent benefits will be well worth any temporary costs:

- ?? Instead of bankruptcy, solvency.
- ?? Instead of unfunded promises, accumulating wealth.
- ?? Instead of higher taxes, lower taxes.
- ?? Instead of budgetary crowd-out, expanding revenues.

- ?? Instead of negative returns, positive ones.
- ?? Instead of dependency, ownership of real assets.

### **Third Rail No Longer**

Is Social Security still the third rail of American politics—touch it and you die? I don't believe it is. As demonstrated by the victories of George W. Bush in 2000 and Randy Forbes in Virginia this year, the juice is going out of that rail.

Real rates of return have fallen to such abysmal levels that voters of all ages are increasingly willing to consider sensible reforms. Indeed, we may be at a point in the program's history when, like welfare reform in the mid-'90s, the issue actually hurts the defenders of the failing status quo and favors reformers.

But to make the right choices, voters must hear the plain truth from their leaders. As a first step, I think we should modernize the annual Personal Earnings and Benefit Estimate Statement, or PEBES, workers receive from the Social Security Administration, so that it gives folks the straight scoop: an accurate and unbiased picture of Social Security's poor returns and massive underfunding. Today's statements are hopelessly optimistic and misleading on both counts.

*Voters  
need to  
hear the  
truth,  
now.*

I would urge you to begin talking with your constituents about this issue now. You don't want them taken by surprise when the Commission's report appears next December. I think we'll find voters are more intelligent and open-minded about serious reform than our opponents would have us believe. Whenever we vote on a true reform plan—be it next year or two years from now or four years from now—we need to begin laying the groundwork today.

In conclusion, let us rededicate ourselves to the limited government of our Founders. Let us work to make America better for our children and grandchildren. Over the next ten years, let us:

- ?? Preserve the 2001 tax cuts and make them permanent.
- ?? Work toward fundamental tax reform.
- ?? Enact free-market health reforms.
- ?? And preserve and strengthen Social Security for the long haul.

See you next week.